

The University of Chicago

A CLASSIFICATION OF
INCOME AND EXPENDITURES FOR
MUNICIPALITIES

A PART OF A DISSERTATION SUBMITTED
TO THE FACULTY OF THE DIVISION OF THE
SOCIAL SCIENCES IN CANDIDACY FOR THE
DEGREE OF DOCTOR OF PHILOSOPHY

DEPARTMENT OF ECONOMICS

1936

By

ARTHUR NICHOLAS LORIG

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CHAPTER I

INTRODUCTION

In municipal accounting, the classification of income and expenditures holds a dominant position. Such a classification presents a set of accounts for recording and summarizing items of income and expenditure in a manner to produce necessary or desired financial information. Since most of the financial data sought by municipal executives, legislators, citizens, and other interested groups concern income and expenditures, the classification takes a very important place in the accounting system.

The objective of this study was to make available for municipalities a model classification of income and expenditures. As a model, the classification was designed to furnish more of the necessary and desired financial information than would any other classification--recognizing, however, that the cost of securing any information should not exceed the value attributed to the information nor the cost of acquiring it in any other way. Moreover, the classification was made adaptable to municipalities of varying sizes, for its extended use would result in added advantages. If a model classification is adopted by a number of municipalities, advantageous uniformity will be brought into much of their accounting.

The provision of a model classification of municipal income and expenditures has exceptional significance at the present time. It could be of service in the present broad movement to bring uniformity and improved methods into the accounting for municipalities of the United States. Although efforts along the same line have been made in the past, much progress remains to be made before uniformity is achieved and before adequate accounting becomes general among municipalities. The model classification here proposed might opportunely serve as a factor in the movement.

Many advantages are to be obtained from uniformity in municipal accounting.¹ It seems convenient to describe the

¹ Most of the advantages contain an inherent assumption that a model system of accounting will be used. This seems a proper assumption. Extensive uniformity can only be obtained by co-operation in adopting a system or by forcing its adoption, and

advantages as they relate (1) to the state, (2) to the municipality, and (3) to others.

A state may bring about approximate uniformity in the accounting of its municipalities by requiring the adoption of a model system of accounting and then auditing the accounts regularly. In doing this, assurance will be given that all municipalities are using satisfactory accounting methods. Moreover, any control the state may wish to exercise over municipal finances may be aided by planning the accounts to disclose any failure to observe rules and restrictions. Local authorities have less opportunity to conceal or distort information.

Auditing of the municipal accounts by the state will also be facilitated. The auditors can interpret the accounts more readily and can make more useful comparisons and suggestions. They spend less time learning the system and more time at constructive work.

Uniformity in accounting is probably more important to the municipalities themselves than to the state. The advantages are more apparent. A model system designed for the use of many cities may be prepared by accountants abler than those whom a single municipality could afford to employ. Hence, it tends to provide better accounting for the municipality. Furthermore, standardization of accounting forms can be expected, resulting in a lower cost and less need for carrying a substantial inventory of forms.

The common language, standardized titles, and similarly prepared accounts and statements, which result from uniform accounting, foster easy and somewhat useful comparisons with other municipalities. While differing conditions would tend to invalidate comparisons, some will unquestionably prove satisfactory and informational. One municipality cannot feel certain it is doing well unless it learns what others are doing.

New employees, such as accountants, city managers, etc., when experienced with the system elsewhere, adapt themselves quickly to the accounting aspect of their new positions. Furthermore, the positions are made more attractive, for that which is learned about the system can be used in working for other municipalities. As a result it seems reasonable to expect that better men could be obtained and that the necessary salary scale would be less.

Uniform municipal accounting also brings advantages to

there would be little point in making the effort to secure uniformity unless a model system were to be used.

individuals and organizations not directly connected with the state or municipal government. Compilers of statistics on municipal governments are able to obtain more comparable data from the reports of municipalities, for the accounts of each must be treated in the same way. Consequently uniformity in accounting leads to the preparation of more accurate and probably a greater abundance of statistical information.

The whole subject of municipal accounting is made more attractive when municipal accounting practice is relatively uniform. Schools are able to teach it with less difficulty. Students are enabled readily to apply what they learn to a much wider field. Others, too, tend to become more interested, for, in moving to a new municipality, they have less difficulty becoming informed regarding operations of their new government. The language and form of the municipal reports are quite familiar to them.

There are, however, certain limitations and disadvantages in the use of a uniform system of municipal accounting. Because the organization and local conditions of municipalities differ, it is not desirable to extend uniformity into the accounting procedure and the detailed accounts. Furthermore, the system must be adaptable to the accounting needs of municipalities of various sizes. Were this not true, the system would either be inadequate for the larger municipalities or unnecessarily elaborate and expensive for the smaller ones.

Fortunately, a high degree of uniformity exists in both the sources of income and the activities of municipalities. In accounting for these, considerable uniformity can be obtained without difficulty. Moreover, by not providing a fixed accounting procedure or detail accounts, an opportunity is given the larger municipalities to expand their accounting to meet their needs without departing from the essentials of the classification.

The development of the classification involved the accumulation of certain important data concerning municipalities, such as the character and sources of income, the kinds of activities and the various ways of performing them, and the terminology in general use. In addition, the organization units commonly found and their relationship to the activities and to each other needed to be determined. From this information the classification was erected, following the general plan to be outlined.

CHAPTER II

THE DEVELOPMENT OF THE CLASSIFICATION

In preparing this classification of income and expenditure accounts for municipalities, an attempt was made to make it complete enough to apply to the large cities and yet flexible enough to be conformable to the more modest accounting requirements of small municipalities. It is intended that a municipality shall be able to select from the classification income and expenditure accounts suitable to its particular needs, and that by doing so it will bring its accounts into greater uniformity with those of other municipalities.

The information the accounts are required to provide dictates what the particular accounts and their arrangement should be as well as the basis of accounting to be used. The kinds of information may be outlined as follows:

Information regarding the financial condition of funds:

All the resources (cash, amounts receivable of various kinds, and inventories), all the liabilities, and the various reserves. From them the unappropriated surpluses or the deficits may be determined.

Information concerning the financial condition of appropriations:

The amounts of the appropriations and the expenditures and the encumbrances to date.

Information regarding current operations:

Income classified by fund, character, organization unit, activity and object, compared with appropriations and allotments.

Profits and losses of public utilities and other activities self-supporting in their nature.

Additional information used in budgeting:

Income, cash receipts and expenditures of previous, though recent, years. These are to be compared with current data and estimates for the present and coming years.

Details of the public debt.

Information for cost accounting:

Expenditures classified by organization unit, activity and object.

Stores accounting.

Depreciation on properties.

Miscellaneous:

Cash receipts and disbursements in sufficient detail to permit their verification and their relation to the proper funds.

Information for internal check in addition to cash verification of amounts receivable, stores and amounts payable. Unpredictable information for operating and other statistics.

The choice of a basis of accounting.--Two methods of accounting--the cash and the accrual methods--are available to the accountant. In devising a system of accounting he either chooses between them or makes use of both--one method for certain parts of the accounting and the other for the remaining parts.

The method used does not materially affect the chart of income and expenditure accounts. The accrual method requires all the accounts necessary in cash accounting. In addition special accounts are provided for recording income received or expenditures made which are applicable to other fiscal periods. A chart of accounts designed for accrual accounting can, therefore, be used in cash accounting by merely omitting the accounts recording accrued and deferred items only. However, the manner of recording items in the accounts and the results obtained may differ considerably under the two methods. It seems desirable, then, to examine the two methods to determine whether one might be recommended to the exclusion of the other or whether each might be preferable under certain conditions.

The cash and accrual bases are not difficult to distinguish in their pure forms. The cash basis is commonly understood to mean that only cash transactions are to be recorded in the accounts. Income is not recorded until cash is received, and expenditures are entered only when paid for. Income received in advance and prepaid expense are included in the accounts for current operations. Neither receivables nor payables appear in the accounts except when they arise through the loaning or borrowing of cash.

The accrual basis requires that all income and expense related to the present fiscal period, whether affecting cash at the time or not, be recognized and recorded in the accounts, and that all income received in advance and expense prepaid be deferred to the period to which they relate. Income and expense accruing through lapse of time, through the production of goods, etc. (e.g., interest and royalties) are recorded periodically, whenever information relating to them is sought or when payment is made. Receivables and payables are listed in the accounts, and encumbrances (orders placed but the liabilities not yet incurred) are recorded against appropriations.

The difference between the two bases is thus seen to be mainly one of scope. The pure cash basis narrows consideration to cash items only. The pure accrual basis enlarges the accounting viewpoint to include all resources and liabilities and all income and expense, whether affecting cash at the time or not. It is evident that unless a municipality operates on a cash basis, the information obtained under the two methods may differ, and that the cash method, being simpler, will probably cost less to operate.

In actual practice pure accrual accounting and pure cash accounting are found rarely, if at all. Those municipalities which profess to follow the accrual method do not do so in its entirety, while those adhering to the cash method obtain additional information through memorandum records. In many cases these variations are suited to local conditions or needs, and are commendable. In some cases they are apparently due to a failure to perceive what information is helpful or to understand the accounting procedure necessary to obtain the information.

Accrual accounting is seldom carried out to the finest detail. Nor should it be. Certain accrued items of relatively small amount and, therefore, not having an important bearing upon financial information may be properly ignored until the cash transactions covering them take place. Interest and penalties on overdue amounts are thus sometimes omitted even though it is expected that they will probably be collected. If the amount is unimportant it would be folly to spend the time and incur the expense necessary to include the items in the accounts.

In cash accounting as actually practiced, memorandum records are often made of certain non-cash items, such as amounts receivable and payable. While not "tying in" with the general ledger accounts, they do supplement the information obtainable from pure cash accounting--sufficiently, in some cases, to provide ample financial information for good management.

As to whether the cash or accrual method is best in any particular case is largely dependent upon the size of the municipality. The amount and kinds of financial information required vary directly with the amount and variety of income obtained and services offered by the municipality. These in turn vary directly in number and amount with the size of the population. The officials of smaller municipalities (and other interested people) consequently require less information from the accounts than do those of larger municipalities. In fact, they may find that knowledge obtained through personal contact suffices for proper control in certain phases of the municipal finances--in regard to encumbrances or unpaid invoices, for example. A cash system of accounting, simpler than the accrual system and costing less, may then not only be satisfactory but desirable. Where the government is more complex

or deals with many non-cash transactions, personal contact cannot serve as successfully and more reliance must be placed on accounting data. Because of this, the municipalities of moderate or large size and some of the smaller ones require more financial information than the cash system of accounting can offer.

In choosing between the two methods for any particular municipality, the limitations of the cash method should be kept in mind. If non-cash expenditures are substantial in amount, the figures obtained under cash accounting would be too incomplete for use in presenting a true picture of the cost of the municipal activities for a given year. If unit costs of activities are desired, to be determined by a system of cost accounting, the need of complete costs rather than the disbursement figures obtained in cash accounting receives additional emphasis.

Furthermore, when unused materials and supplies and various amounts receivable and payable exist, the financial condition of the municipal funds and appropriations cannot be readily determined through cash accounting. Information as to such items might be obtained by means of special inventories or memorandum records, but the amounts will not be easily verifiable nor as quickly determined when needed as when provided through the regular process of double entry accounting.

Accrual accounting, on the other hand, can provide complete information regarding costs and financial condition whether the non-cash items are many or few. At the same time it can be made to supply cash figures if desired. However, it is more expensive and difficult to operate. Therefore, where the non-cash items are few or unimportant, as in many smaller municipalities, the cash method of accounting would be the logical choice.

It is therefore apparent that a model classification of income and expenditure, if it is to be adaptable to all municipalities, must permit either cash or accrual accounting. As stated previously, a classification based on accrual accounting contains all the accounts which would be used under the cash method, and may therefore be readily adapted to cash accounting. The reverse situation is not true, for a classification formulated on the cash basis does not necessarily contain accrual accounts. Hence, the proposed classification was prepared on the accrual basis.

Methods of classifying.--Several methods of classifying both income and expenditures are necessary in order that all the important financial information may be provided. Each method contributes certain kinds of data; they cannot serve as substitutes for one another. Hence, all of the methods should find place in a complete classification of income and expenditures, related to one another (i.e., some made subsidiary to others) in a manner best suited to furnish the desired information without duplication.

Expenditures are classifiable by fund, by character, by organization unit, by function and activity, and by object of expenditure. Each method finds use in a classification of municipal expenditures and each will be described as its application to the proposed classification is considered. There are other possible classifications, but so little can be stated in their favor that they need no consideration here. Classifying chronologically or by name of vendor are examples.

Income is customarily classified by funds, character, sources, and organization units, and each method will be discussed in its relation to this classification. A functional classification of one major source of income, departmental revenue, is feasible and will also be considered. Again there are other possible methods, -e.g., chronologically and by name of payor--which have few merits and need no comment.

Classification by funds.--The income of a municipality consists principally of the periodic contributions of taxpayers and much of it is specific in character--to be used only for designated purposes. Therefore, a very important requirement of municipal accounting (as distinct from accounting for private industry) is to show whether the income has been properly applied.

This accounting necessity has resulted in the general practice of creating funds--setting apart the resources designated for particular purposes. Each of the funds then requires separate accounting in order to show that all expenditures conform to the restrictions.

The funds in actual use by municipalities vary considerably in title and in the details of their operation, but they are classifiable into the following eight groups: general fund, special revenue funds, working capital funds, utility funds, bond funds, special assessment funds, trust funds, and sinking funds. This classification of funds recognizes, in general, the distinctions necessary to be made between types of funds to reflect differing restrictions or responsibilities in connection with the use of the resources and income.

Classification within the funds.--Within the funds themselves, there must of course be further classification, varying with the type of fund. The classification within the special funds is usually relatively simple, for the limitations often govern the classification. Special revenue funds, special assessment funds, trust funds, sinking funds, and bond funds all have a very limited variety of income, usually from a single source, and their expenditures are likewise exceedingly restricted in scope. When the limitations do not dictate the classification within such funds, portions of the general fund classification

will often be found suitable. In cases where special classifications need to be prepared, the principles governing classification in the general fund apply. Hence, no special analysis of the classifications for these funds need be made.

The accounting for the funds of the two other special groups, utility funds and working capital funds, is not so simple, for both income and expenditures may be quite varied. However, the enterprises or activities financed by such funds are so numerous and may be so large that to provide classifications of accounts for all of them would be a task of tremendous magnitude, quite beyond the possibilities of the present work. Fortunately it appears that all public utilities and all of the activities fostered by working capital funds are duplicated in private industry, and commendable systems of accounting have been worked out for many, if not most of them.

The general fund is of an altogether different nature. In it are placed all varieties of income unrestricted as to use, and they are many. From it are financed all municipal activities not otherwise provided for, and they also are numerous. The classification of income and expenditures within this fund is a complicated problem, one which now will be dealt with in detail.

The influence of the budget upon the classification.--Expenditures from the general fund are not wholly without restriction. As a means of controlling them and of providing sufficient funds to meet them, a budget should be, and usually is, provided. A comparison of the characteristics of the budget with the nature of the information required regarding income and expenditures shows that much of the information desired from the accounts is related to the use of the budget. That is not surprising, of course, inasmuch as the budget was devised mainly as an instrument of control over present and future income, expenditures, and debt, and the transactions with reference to these are recorded in the accounts. Present operations are limited by appropriations made through the budget or the appropriation act, and a comparison of performance with the appropriations gives some of the most valuable information sought for control purposes. Future income and expenditures are also planned through the budget, requiring estimates based to a great extent upon past and present experience.

Under the circumstances it is evident that many, if not most, of the reports to the executives, the legislators, and the citizens should disclose the relation of performance to budgetary figures. It is also evident that the arrangement of the accounts in the budget should be virtually the same as that in the books and in the reports. With the budget as the chief instrument of

control, it seems clear that it is a center about which the accounting should build, dictating the form that the classification should take.

In considering the other common classes of necessary information regarding income and expenditures, it can be shown that they are readily and most easily obtained from the same form of classification which best suits the budget. Therefore, the problem of determining the best classification for the income and expenditures of the general fund is primarily that of determining which is best for budgetary purposes.

The classification of general fund expenditures by character.--Certain expenditures made from the general fund do not apply directly to current operations. They are few in kind but may amount to a considerable sum in the aggregate and seem best separated into several special classes. A classification by character results.

Capital expenditures, constituting one of the classes, may apply partially to the current period, for the assets may be placed to immediate use. But the larger portion represents an investment for the future and should not be charged to current operations. If a system of depreciating capital assets were followed, it would provide for gradually transferring the cost to operations during the years of their use.

Interest, although a current expense, is a fixed rather than an operating expense. Its amount may have been fixed in the past, at least in large part, and therefore may not be subject to the control of present officials. Nor is it attributable to any one activity or division of government, as operating expenses are. For these reasons it is thought best to separate it from the cost of current operations.

Repayment of bonded indebtedness has no direct relation to current expenses. The amounts received when indebtedness is incurred may be used to pay for operating expenses as well as for other purposes. Borrowing, therefore, permits operating expenditures to be made prior to the time when revenue is received to pay for them. The repayment of the indebtedness out of revenue could not also be operating expense.

Another character class consists of outright contributions to working capital funds and utility funds. These contributions are means of financing certain current operations but are not in themselves operating expenditures.

A last class segregates expenditures applicable to other fiscal periods, viz., deferred charges and surplus charges. To include them in current operating expenses would be misleading.

The classification of expenditures by character is there-

fore quite short, consisting of (1) expenses of current operations, (2) capital expenditures, (3) interest and bonded indebtedness, (4) working capital fund and utility fund contributions, and (5) expenditures applicable to other fiscal periods. In the proposed classification, the character classes are made primary within the funds. This seems preferable to placing them within the organization units or the activities.

Classification of current expenses by organization unit.--
In order that the budget shall be serviceable as a means of checking upon financial responsibility, the operating expenditure portion should be classified by organization units (departments, boards, bureaus, commissions, etc.). The responsibility as shown in the organization chart should be "paralleled by expense responsibility in the accounts." With such a division of expenses, periodic accounting reports covering the operations of each of the municipal executives can be made.

The necessary classification by organization unit presents a difficulty to a classification intended to be adaptable to many municipalities. The structures of municipal governments seem to differ greatly; their organization units vary in number, nature, title, and scope. It is quite unlikely that this non-uniformity in organization could permit uniform expenditure accounting unless the organization unit expenditures were divisible into smaller and more comparable units. It happens that this is not only possible but a very logical step. Organization unit expenditures may be divided into expenditures by activity and function¹ and by object of expenditure, both of which are quite uniform as between municipalities.

Either of these two methods of classifying the organization unit expenditures may be made subsidiary to the other, but far more common practice is to have the object classification subsidiary to that by function and activity. The main reason seems to be that total costs for each function and activity appear to have greater usefulness than total costs by object. The discussion of these two methods of classifying will indicate their respective advantages.

The classification of current operating expenses by functions and activities.--Organization unit expenditures can be separated readily into functional and activity expenditures because the working structure of a municipal government should be,

¹"Function" relates to the purpose of the work done, while "activity" relates to the class of work done in order to carry out the purpose described by the function.

and usually is, built around the municipal functions and activities.

In actual practice, the relation of organization units to the functions and activities is far from uniform as between municipalities. This may be due to the fact that there are often several units to which an activity might justifiably be assigned. Nevertheless, an activity is rarely performed by more than one organization unit, probably because of several disadvantages resulting from a division. Duplication of services may result, divided responsibility for the same service exists, and inefficiency occurs through the duplication of physical assets, records, etc. Consequently it is usual to find each organization unit responsible for one or more entire activity.

Classifying the expenditure accounts within the departments by activities is, therefore, a logical step. Furthermore, it gives an excellent arrangement of costs for providing information to the legislature and the public. The cost of an activity compared with the expected benefits to be derived from it should give a basis for intelligent decision as to whether the activity should be increased, continued as in the past, decreased, or discontinued entirely. This activity cost also serves as an admirable basis for unit cost finding. A final point in its favor--one which was pointed out previously--is that the functions and activities of municipalities are much the same the country over. Classifying expenditure accounts by activities therefore results in some uniformity in accounting sufficient to promote a profitable comparison of costs.

The model classification presents a comprehensive classification of current operating expenses by activities. The activities possibly might have been presented without any attempt to group them under organization units, for the municipalities are expected to select the accounts for their respective activities and classify them according to their own organization unit structure. However, the grouping by organization unit in this classification is convenient for locating accounts and referring to them as well as for showing certain relationships between them. It will also be helpful in illustrating for municipalities how the classification may be adapted to their own accounting system. Furthermore, the organization unit structure used follows for the most part common tendencies in such structures, and each municipality is likely to find much of it quite similar to its own.

There are provided in the classification of operating expenses ten primary divisions, based chiefly upon major functions. This follows the previously stated principle that the organization should be built around the functions. Public Safety, Public

Health, Public Welfare, Education and Recreation are all clearly functional classes and are used by many municipalities. General Government is not a functional class, but brings the accounts of the various departments of general government together for convenience.

Public Works is not functional in itself but groups together several functions often related to each other--the promotion of cleanliness, the maintenance of streets and waterways, and the control of flood water. Public Service Enterprises and Municipal Service Departments are ordinarily operated by means of special funds. When operated through the general fund, it seems convenient to regard them as separate primary divisions. A final division is Miscellaneous, covering the few operating expenses not assignable to any other division.

As previously indicated, many municipalities have organization units coinciding with some of the ten summary divisions of operations and with some of their sub-groups. But whether actual organization units coincide with the divisions and groups or not, it is possible to assemble activities into such classes to permit a rough comparison of their totals with those of other municipalities.

The classification of current operating expenses by objects of expenditure.--One further classification is necessary--by object of expenditure (i.e., by article or service purchased). When made subsidiary to the other methods of classifying, it carries the classification into the final details.

The classification by object of expenditure might take any one of three forms. It could be a general classification applicable to any and all activities and organization units of the municipality; it might consist of individual classifications specially prepared for each activity; or it might be a compromise between the two, having broad general classes applicable to all the activities, but detail accounts specifically prepared for the individual activities. The relative merits of these possibilities require close scrutiny.

A general classification aims at uniformity in accounting by object of expenditure throughout the entire municipal government. Although the accounts for each organization unit or activity are kept separate, it is possible to combine their respective subsidiary accounts in a new analysis, arriving at total expenditures by object for the whole municipality. The classification might be made to call for extreme details such as differentiating between different qualities of materials, or it might be quite concise, prescribing only a few broad classes.

The advantages to a municipality of a concise uniform classification by object are not very apparent. Figures showing

the amount paid by the municipality for personal services, contractual services, supplies, materials, and the like are probably useful statistically, and the accounting procedure would be simple. On the other hand, with such brief classification, the accounting for each activity would be so restricted as to offer little useful information to the executive in charge.

An elaborate classification would improve the usefulness of the combined figures for the municipality, but whether sufficiently to warrant the work involved in obtaining them is still questionable. Very minute detail would be of value in pointing out where consolidated purchasing might save money or where the government might undertake to perform certain services itself instead of having them done by others. But a very occasional report of such total expenditures, derivable through a special statistical study, might serve the same purpose. Frequent periodical reports along such lines would seem to burden the accounting rather needlessly. If centralized purchasing is practiced (and this is advocated for municipalities of all sizes) much of such information can be obtained without the aid of such an accounting arrangement.

The second possibility, that of providing a special classification for each activity, would appear to be more satisfactory. The cramping effect of a fixed list of accounts could be avoided. The specific nature of each activity could determine the accounts, significant titles could be chosen, and through them clear pictures of the cost of activities could be prepared. The amount of detail to be shown could be left to local judgment. It would depend upon various local conditions, including the size of the municipality, the importance attached to the activity, and possibly the wishes of the executive in charge.

Expenditures by objects readily fall into several broad classes, such as personal services, materials and supplies, etc. It is possible to prescribe these classes for each activity and yet permit the detail accounts thereunder to reflect the individualistic nature of the activities. There seem to be no particular disadvantages to this method. On the other hand, it promotes some uniformity in object accounting and thereby permits obtaining information as to the totals of such classes of object expenditure for the entire municipality.

The same reasons for preferring a specific classification for each activity to a general classification in any one municipality would apply for this model classification meant to serve many municipalities. The general classification might have one additional advantage when more than one municipality is concerned. Being simpler, it might gain readier acceptance. But this seems

a doubtful advantage when it necessitates forfeiting the clearer analyses obtainable through a specific classification of each activity. The problem can therefore be reduced to whether or not specific detail accounts for each activity should be included in this proposed classification.

The advantages to be gained through the inclusion of an object classification by specific detail accounts are several. As a model of good accounting, it would raise the standard of the detail accounting if it could be made inclusive enough to cover all the varying methods of performing activities. Secondly, in consolidating the reports of the municipalities within certain districts or states, consolidated detail, if desired, would be more easily obtained and more accurate when the detailed accounts are uniform. Lastly, comparisons of costs of activities between municipalities might be more enlightening when the detail follows a definite form, although prescribed classifications may tend to hide differences in methods and actually bring deception.

There is one important disadvantage to including a specific object classification in a uniform chart of accounts. Whereas activities are quite uniform between municipalities, the methods of performing services may not be. The cleaning of streets, the relief of the poor, and control of traffic are examples of activities variously performed. In applying detail accounts for the recording and reporting of such activities in any municipality it would seem necessary to study the particular situation carefully. A detailed classification attempting to prescribe for a host of municipalities would tend to be constricting and to handicap descriptive reporting. Certainly the titles of the accounts would tend to be more rigid and not as explanatory as they might be.

It would seem disadvantageous, therefore, to include detail object accounts as part of the classification presented here. However, there seems no objection and some advantage to prescribing broad general classes of object accounts. The municipalities are advised to prepare object accounts suitable to the conditions surrounding each of their various activities, but to group them under (1) Services--Personal, (2) Services--Contractual, (3) Commodities, (4) Current Charges, and (5) Current Obligations.

The classes given are adapted from A. E. Buck's classification by objects and are on the whole similar to those in common use. Two other object classes, Properties and Debt Payments, are also character classes within this model classification and therefore will not be found under activities.

The subclassification of other character classes.--A classification of capital expenditures by land, equipment, and build-

ings and other improvements is customary and necessary in order that detailed inventory records may be maintained and depreciation (if it is to be considered) may be calculated. During construction and development, each capital project must be separately accounted for in sufficient detail to enable verification of costs and comparison with the detail in the authorization. Purchases of land, buildings and equipment are also individually accounted for and compared with their authorizations. When the budget shows authorizations for capital expenditures classified by organization unit or activity, the accounts must show a similar classification.

For informational purposes, interest is divided into that paid on bonded indebtedness and that on current indebtedness. A distinction between amounts paid in direct reduction of bonded debt and amounts contributed to sinking funds is also necessary for the bond statements.

No particular classification need be provided for working capital fund and utility fund contributions. They are few in number and should be recorded individually. Expenditures applicable to other fiscal periods are naturally divisible into those for future periods (deferred charges) and those for past periods (surplus charges).

The relation of cost accounting to the model classification.
Municipal cost accounting is of growing importance and a model classification of expenditures should be able to provide the financial data necessary for costing. The proposed classification appears adequate to meet these needs. It classifies expenditures by organization units and activities, both of which are basic to cost accounting. It avoids prescribing object accounts, enabling the particular cost systems desired to establish their own detailed accounts. The activity accounts are suited to serve as control accounts for costs, while more detailed controls may be readily established by adding operation or major object accounts subsidiary to the activity accounts. The two systems of accounts thus could be properly co-ordinated.

The classification of income.--To obtain the financial information necessary to its control, municipal income should be classified by fund, character, source, and organization unit. The classification by funds has already been described. It has also been pointed out that the income of special funds other than utility and working capital funds is either limited to a single source or is classifiable according to the principles used in general fund classification, and that municipal utilities and the activities fostered by working capital funds have duplicates in private business, with good classifications of accounts already worked out for many, if not most, of them. It remains to describe

the development of a classification of income for the general fund--by character, by source, and by organization unit.

Classification of income by character.--Income of a fund refers to an increase in the net resources or surplus of the fund. But all increases in the net resources of a particular fund do not result in an increase in the net resources (and therefore the income) of the whole municipality. Sometimes other resources of the municipality, not a part of this fund, may decrease correspondingly, leaving no net gain to the municipality as a whole.

Three distinct classes of fund income which are not municipal income may be illustrated.¹ When a utility fund makes a contribution to the general fund, the net resources (and therefore the income) of the latter increase, while the resources of the former decrease. When fixed properties, not carried in the general fund, are lost and insurance recovery is made, or when they are sold, and the money is placed in the general fund, its income is increased, but the resources of the whole municipality are not (except for possible profit). Thirdly, the amount received from the sale of an issue of bonds is placed in a bond fund, but the liability is recorded elsewhere under bonded debt accounts. The income of the bond fund is increased; the income of the municipality is unaffected by the transaction. It would be misleading not to distinguish such fund income from that which is income of the whole municipality.

Under accrual accounting, another class of income should be separated--that applying to other fiscal periods, resulting in deferred income or surplus credits. The deferred income relates to future fiscal periods and is carried forward to those periods. Surplus credits represent income applying to past fiscal periods and therefore increase the surplus carried forward to the present period.

From these distinctions, a character classification of five classes is evolved: (1) current revenue, (2) sale and compensation for loss of properties, (3) contributions from other government-owned funds, (4) sale of bonds, and (5) income applicable to other fiscal periods. All but the fourth are found in the general fund classification.

Classification of income by source.--Municipal income should be classified by source. This is the opinion expressed in all the writings found dealing with the subject. Since the income

¹This discussion refers to government-owned funds only. Income of privately-owned trust funds would not be municipal income.

from certain sources is designated by law to particular uses (and therefore placed in special funds), that income, at least, must be classified by source. Moreover, sources give the best basis for budget estimates of income for the succeeding year. Certain sources may be abandoned, new ones discovered and added, some probed deeper, and other not exploited so much. The conditions surrounding each of the various sources are direct determinants of income. Even if it were desired to estimate income to be collected by organization units, an analysis of the sources contributing income to the units would be necessary.

Another reason for source classification would be the possibility it provides of determining which sources, if any, are producing less than the cost of collection. Unless some motive other than the acquisition of income is present, an "unprofitable" source is best abandoned.

The income of the general fund included within the character classes other than Current Revenue is so restricted in variety that it needs no elaborate classification. The class, Sale and Compensation for Loss of Properties, is a source in itself. The income included therein is incidental and would seem to require no subclassification unless the amount happens to be large. Then individual important transactions or groups of similar transactions may be accounted for separately if information relative thereto is desired. Contributions from Other Government-Owned Funds, itself a major source, will show the contributing funds as the detail sources. Income Applicable to Other Fiscal Periods will be affected by income derived from a few sources only. That income relating to previous periods is credited to the fund surplus and needs no further classification. That applying to future periods (deferred income) should be classified by sources in order that the accounts for current revenue by sources may be credited when the appropriated period arrives.

In the proposed classification, the sources of current revenue are grouped into eight main classes, viz.: (1) Taxes; (2) Permits, Non-business Licenses, and Other Privileges; (3) Fines, Forfeits and Other Penalties; (4) Grants and Donations; (5) Rents and Royalties from Non-departmental Properties; (6) Interest, Discount, Premium, and Dividends; (7) Departmental Revenue; and (8) Miscellaneous Revenue. For the most part the sources are clearly assignable to particular classes, but this is not always the case. Some sources can with reason be included under either of two classes. It was therefore necessary to be somewhat arbitrary in classifying certain sources, but that has only slight significance. The classes are used primarily as convenient places to locate certain sources in the statements and reports and in the accounts. If a municipality

chooses to shift a source to another class , that matters little. The class totals are only of secondary importance, and the amount of income within a class arising from such arbitrarily grouped sources would in practically all cases be relatively small. The individual sources are of greatest significance for they give the proper information for control and comparison.

The specific sources of income appearing in the main classes are quite numerous and are further classified into related groups, particularly for convenience in locating them, but partially because of certain similarities which might cause their close association to give some useful information. Again occasionally difficulties arise in classifying some of the sources into these minor groups, bringing the necessity of making some arbitrary rules. But again the arbitrary rules have only slight significance. The fact that each source must be accounted for and reported separately permits reclassification of the sources if desired.

Classification of income by organization unit.-- Some municipalities also desire to classify income by organization units-- i.e., by collecting agencies. When practically all collecting is done through the treasurer's department this is unnecessary, of course. However, such is not always the situation. Sometimes various organization units retain the amounts they collect for their own use. They then need to be charged with the amounts. Classification by organization unit is required under such conditions. But when all the amounts collected are placed in the treasurer's control, there seems little purpose to classifying income in this way except for possible auditing advantages and to judge the relative efficiency in the collection of income.

For the purpose of safeguarding cash, it would seem preferable to collect income through a single department so far as convenience permits. Conditions peculiar to a municipality, however, may cause some collections to be made by other units. In the model classification no such conditions could be anticipated, and a classification by organization units was impossible (except to the extent of suggesting that departmental revenue be classified by departments). Any arrangement for collecting found necessary in a municipality must provide its own individual classification by organization unit.

The position of such a classification in the whole income classification (i.e., whether subsidiary or primary to the source classification) would also seem to be a matter determined by local conditions. Probably it should be entirely separate from the larger classification.

Departmental revenue is exceptional in that it arises from departmental activities or ownership of departmental properties

and therefore should be classified by departments. At the same time the revenue should be classified by function and activity. The net cost (expense less income) of each activity or function can then be determined.

CHAPTER III

A CLASSIFICATION OF INCOME AND EXPENDITURES FOR MUNICIPALITIES

The proposed classification of income and expenditures accounts is here presented as a list or chart of accounts grouped into significant classes, available for use by local governments. From the chart a municipality may select the accounts suited to its particular activities and forms of income. The detail prescribed in the various classes of accounts may be expanded or contracted to satisfy the requirements of the particular municipality; a large municipality may wish to split up some of the accounts, and a small one will find some of the suggested accounts superfluous and may find it necessary to combine others. If the organization of the municipal government differs from that used in the classification, the accounts should be shifted to follow the actual organization.

In addition to the complete classification for a general fund, there is included a fund classification and lists of the primary divisions appearing in the income and expenditure classifications.

Fund Classification

- General Fund
- Special Revenue Funds
- Working Capital Funds
- Utility Funds
- Bond Funds
- Special Assessment Funds
- Trust Funds
- Sinking Funds

INCOME CLASSIFICATION

General Fund Income

Primary Divisions

- A. Current Revenue
 - I. Taxes
 - II. Permits, Non-business Licenses, and Other Privileges
 - III. Fines, Forfeits, and Other Penalties
 - IV. Grants and Donations
 - V. Rents and Royalties from Non-departmental Properties
 - VI. Interest, Discount, Premium, and Dividends
 - VII. Departmental Revenue
 - VIII. Miscellaneous Revenue
- B. Sale and Compensation for Loss of Properties
- C. Contributions from Other Government-owned Funds
- D. Income Applicable to Other Fiscal Periods

General Fund Income

Detailed Classification

A. Current Revenue

I. Taxes¹

- 1. General property taxes
 - a. Taxes on real property
 - b. Taxes on personal property
 - (1) Taxes on tangible personal property
 - (2) Taxes on intangible personal property

¹ It may be desired for informational purposes to divide Taxes into the two main divisions of (1) local levies, and (2) State (and/or County) administered locally-shared taxes.

2. Specific property taxes
3. General corporation taxes
 - a. Corporation income tax
 - b. Capital Stock tax
 - c. Other general corporation taxes (to be accounted for individually)
4. Special taxes on banks and other financial institutions
5. Special taxes on insurance companies
6. Special taxes on public utilities
7. Special business license taxes
 - a. Amusement licenses
 - b. Manufacturing licenses
 - c. Merchandising licenses
 - d. Other business licenses
8. Poll taxes
9. Personal income taxes
10. Inheritance and estate taxes
11. Gasoline taxes
12. Other taxes (to be accounted for individually)
- II. Permits, non-business Licenses, and Other Privileges
 1. Street privileges
 - a. Extensions beyond building lines
 - b. Stands
 - c. Other street privileges
 2. Sundry permits
 - a. Building permits
 - b. Street opening permits
 - c. Sewer tapping permits
 - d. Other permits (account for each class separately)
 3. Animal licenses
 4. Vehicle licenses
 5. Marriage licenses
 6. Other privileges (account for each class separately)
- III. Fines, Forfeits, and Other Penalties
 1. Fines
 - a. Court fines
 - b. Other fines
 2. Forfeits
 3. Tax penalties
 4. Other penalties
- IV. Grants and Donations
 1. Grants
 - a. Grants from the national government
 - b. Grants from the state government
 - c. Grants from the county government
 2. Donations

V. Rents and Royalties from Non-departmental Properties

1. Lease of municipally-owned utilities
2. Other rents and royalties

VI. Interest, Discount, Premium, and Dividends

1. Interest earned
 - a. Interest on bank balances
 - b. Interest on delinquent taxes
 - c. Interest on investments
 - d. Other interest earned
2. Discount received
3. Premium on indebtedness
4. Dividends earned

VII. Departmental Revenue (a separate classification for each department)

1. Fees and other charges for services rendered
2. Departmental sales
 - a. Sale of publications, maps, etc.
 - b. Sale of junk, waste, etc.
 - c. Miscellaneous departmental sales
3. Departmental rents and concessions
 - a. Rents
 - b. Concessions
4. Other departmental revenue (account for each type separately)

VIII. Miscellaneous Revenue

B. Sale and Compensation for Loss of Properties

C. Contributions from Other Government-Owned Funds

1. Contributions from active funds
2. Surpluses from discontinued funds

D. Income Applicable to Other Fiscal Periods

1. Deferred credit

EXPENDITURES CLASSIFICATION

General Fund Expenditures

Primary Divisions

- A. Expenses of Current Operations
 - I. General Government
 - II. Public Safety
 - III. Public Health
 - IV. Public Works
 - V. Public Welfare
 - VI. Education
 - VII. Recreation
 - VIII. Miscellaneous
 - IX. Public Service Enterprises
 - X. Municipal Service Departments
- B. Capital Expenditures
- C. Interest and Bonded Indebtedness
- D. Working Capital Fund and Utility Fund Contributions
- E. Expenditures Applicable to Other Fiscal Periods

General Fund Expenditures

Detailed Classification

- A. Expenses of Current Operations
 - I. General Government
 - 1. Legislative
 - 2. Chief executive
 - a. Mayor
 - b. Manager
 - 3. General administrative
 - a. Finance
 - (1) General accounting and control
 - (2) Special accounting and auditing
 - (3) Assessment and levy of revenue

- (4) Treasurer and collection of revenue
 - (5) Issue and redemption of evidences of debt
 - (6) Purchasing
 - (7) Other finance
 - b. Law
 - c. Clerk
 - d. Civil service
 - e. Planning
 - f. General government buildings and grounds
 - g. All other
- 4. Judicial
- 5. Elections
- II. Public Safety
 - 1. Supervision
 - 2. Police department
 - a. Administration and general office
 - b. Uniformed patrol
 - (1) Foot patrol
 - (2) Automotive patrol
 - c. Detection of crime
 - (1) Criminal investigation
 - (2) Criminal records and identification
 - (3) Morals control
 - d. Traffic control
 - (1) Traffic officers
 - (2) Traffic signals
 - (3) Traffic lines, markers, and safety zones
 - (4) Public vehicle regulation
 - e. Permanent details
 - f. Custody of recovered property
 - g. Animal pound and humane society
 - h. Police signal system
 - (1) Radio
 - (2) Telephone and alarm
 - i. Police training
 - j. Medical service
 - k. Meals for prisoners
 - l. All other
 - 3. Fire department
 - a. Administration and general office
 - b. Fire fighting and rescue work
 - (1) All but fireboat service
 - (2) Fireboat service
 - c. Salvaging
 - d. Fire prevention

- e. Fire alarm system
- f. Hydrants and water service
- g. Firemen training
- h. All other
- 4. Inspections for protection of persons and property
 - a. Administration and general office
 - b. Building inspection
 - c. Plumbing inspection
 - d. Electrical inspection
 - e. Gas inspection
 - f. Boiler inspection
 - g. Elevator inspection
 - h. Weights and measures inspection
 - i. Smoke inspection
 - j. Other inspections
- 5. Registration of deeds, mortgages, etc.
- 6. Militia and armories
- 7. Other protection

III. Public Health

- 1. Administration and general office
- 2. Vital statistics
- 3. Prevention and treatment of communicable diseases
 - a. Tuberculosis
 - (1) Hospitalization
 - (2) All other
 - b. Venereal diseases
 - c. Other communicable diseases
 - (1) Immunization
 - (2) Quarantine and disinfection
 - (3) Extermination of rodents, mosquitoes, and flies
 - (4) Hospitalization
 - (5) All other
- 4. Child Hygiene
 - a. Prenatal hygiene
 - b. Infant and preschool hygiene
 - c. School hygiene
 - d. Miscellaneous
- 5. General hospitalization
 - a. Municipal hospitals
 - b. All other
- 6. Clinics
- 7. Field nursing
- 8. Health inspections
 - a. Milk regulation and inspection

- b. Food regulation and inspection
- c. Sanitary inspections
- 9. General health education
- 10. Miscellaneous
- IV. Public Works
 - 1. Supervision
 - 2. Engineering
 - 3. Promotion of cleanliness
 - a. Administration and general office
 - b. Sewers
 - (1) Collection system
 - (a) Sanitary sewers
 - (b) Storm water sewers
 - (2) Sewage treatment and disposal
 - c. Street cleaning
 - (1) Flushing
 - (2) Machine sweeping
 - (3) Hand sweeping
 - (4) Sweepings collection and disposal
 - (5) Miscellaneous
 - d. Refuse collection and disposal
 - (1) Refuse collection
 - (a) Garbage collection
 - (b) Rubbish collection
 - (c) Ashes collection
 - (2) Refuse disposal
 - (a) Garbage disposal
 - (b) Rubbish disposal
 - (c) Ashes disposal
 - e. Dead animal collection and disposal
 - f. Night soil collection and disposal
 - g. Comfort stations
 - h. Other cleaning
 - 4. Streets and bridges
 - a. Administration and general office
 - b. Street repairs
 - (1) Paved streets
 - (2) Unpaved streets
 - (3) Curbs, gutters, and ditches
 - (4) Sidewalks and crosswalks
 - (5) Culverts
 - (6) Fences, walls, etc.
 - (7) Street signs and house numbers
 - c. Bridge operation and repairs
 - d. Dust prevention

- e. Street lighting
- f. Snow and ice removal
- g. Wood cutting
- h. Miscellaneous

5. Flood control

6. Waterways

V. Public Welfare

1. Supervision

2. Charities

- a. Administration and general office
- b. Direct relief
 - (1) Home relief
 - (2) Relief to homeless adults
 - (3) Emergency relief
 - (a) Unemployment relief
 - (b) Other emergency relief
 - (4) Care of children
 - (5) Care of defectives
 - (6) Mothers' aid
 - (7) Veterans', soldiers', and sailors' relief
 - (8) Old age assistance
- c. Charitable institutions (municipally-owned)
- d. Grants to private charitable institutions and agencies
- e. Work relief
- f. Miscellaneous

3. Corrections

- a. Supervision and general office
- b. Corrections for adults
 - (1) Jails
 - (2) Workhouses and prison farms
 - (3) Others (account for each separately)
- c. Corrections for minors
 - (1) Detention homes
 - (2) Others (account for each separately)
- d. Probation boards and officers
- e. Miscellaneous

VI. Education

- 1. Schools
- 2. Libraries
- 3. Museums
- 4. Others (account for each separately)

VII. Recreation

- 1. Supervision and general office
- 2. Indoor recreation centers

3. Play arena and play projects
 - a. Playgrounds
 - b. Bathing beaches
 - c. Swimming and wading pools
 - d. Athletic fields
 - e. Tennis courts
 - f. Golf courses
 - g. Camps
 - h. Winter sports
 - i. Others (account for each separately)
4. Celebrations and public entertainments
 - a. Anniversaries and celebrations
 - b. Musical entertainment
 - c. Other entertainments
5. Parks and trees, shrubs, etc.
 - a. Administration and general office
 - b. Planting and care of trees, shrubs, etc.
 - (1) Trees
 - (2) Shrubs, lawns, and flowers
 - (3) Nurseries
 - c. Maintenance of other park improvements
 - (1) Roads, walks, and bridle paths
 - (2) Lakes and waterways
 - (3) Park structures and equipment
 - d. Zoos, aquariums, etc.
 - e. Park lighting
 - f. Park policing
 - g. All other

VIII. Miscellaneous

1. Pensions and gratuities to former employees
 - a. Policemen
 - b. Firemen
 - c. School employees
 - d. All other
2. Contributions to non-charitable organizations
3. Memorials
4. Publicity
5. Administration of public trust funds and investments
6. Judgments and losses
7. Unclassified

IX. Public Service Enterprises (see also "Utility Funds")

1. Port
2. Airports
3. Markets
4. Scales

5. Cemeteries and crematories
6. Halls and auditoriums
7. Housing
8. Others (account for each separately)
- X. Municipal Service Departments (see also "Working Capital Funds")
 1. Central storage and supply department
 2. Shops and garage
 3. Electrical department
 4. Yards and stables
 5. Gravel pits and stone quarries
 6. Stone crushers
 7. Asphalt plants
 8. Laboratories
 9. Printing plant
 10. Building operation and maintenance department
 11. Others (account for each separately)

B. Capital Expenditures

Classify construction and development work primarily by project.¹ The projects and other capital expenditures may be classified by the divisions of government and activities already indicated in the foregoing expense accounts and by object accounts (land, buildings, machinery, etc.).

C. Interest and Bonded Indebtedness

1. Interest
 - a. On bonded indebtedness
 - b. On temporary indebtedness
2. Reduction of bonded indebtedness
3. Sinking fund contributions

D. Working Capital Fund and Utility Fund Contributions

E. Expenditures Applicable to Other Fiscal Periods

1. Deferred charges
2. Surplus charges

¹ In accounting for Federal Public Works Administration projects, refer to Federal Emergency Administration of Public Works, Manual of Financial and Accounting Procedure for Public Bodies (Washington: Government Printing Office, 1934).

CHAPTER IV

CONCLUSION

The adaptation of the proposed classification to the accounting needs of a municipality may involve some adjustment. The expenditure classification has been made very complete, covering all of the usual municipal activities and many unusual ones encountered in this investigation. The income classification is also inclusive, providing accounts for all of the sources of income noted in the study. Few, if any, municipalities carry on all of the activities or enjoy all of the sources of income for which accounts are given. Hence only those sections of the classification covering the actual activities and sources of income of a municipality should be selected for its use. If new activities or sources of income are met with, accounts for them may be inserted readily in appropriate sections. When an activity is performed by an organization unit other than the one under which its accounts appear in the classification, the accounts may be shifted. The adaptation to particular needs is therefore not difficult to make, nor are the fundamentals of the classification disturbed thereby.

The chief contribution of this study is the provision for a classification of income and expenditures suited to the use of municipalities of various sizes and varying local conditions, and capable therefore of becoming an instrument for greater uniformity and improvement in municipal accounting. The study also discusses certain controversial points regarding municipal accounting. It is the opinion of the writer: (1) that factors other than informational needs should have little effect upon the type of accounting system adopted; (2) that the accrual method is preferable to the cash basis of accounting for all but some of the smaller municipalities; and (3) that the classification of expenditures by object should be subsidiary to that by activities in a classification of income and expenditures for municipalities. Finally, the study is presented in the hope that it may be of great practical value to municipal accountants.

